

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-83(3)S
Sales Tax
February 15, 1983

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. S811020A

On October 20, 1981, a Petition for Advisory Opinion was received from Benton & Bowles, Inc., 909 Third Avenue, New York, New York 10019.

The issue raised is whether a private telephone system which Petitioner had installed in leased premises constitutes a capital improvement for purposes of the Sales Tax imposed under Article 28 of the Tax Law.

Petitioner, a lessee of real property, entered into a contract for the furnishing and installation of a private telephone system. The major components of the system and their manner of annexation to the real property leased by Petitioner are, as stated by Petitioner, as follows:

- | | |
|-------------------------------|---|
| 1) Processing Unit | 1-3) Bolted to concrete floor via bolts imbedded in concrete; also attached to walls via bolts. Removal would cause structural damage to floor and walls in the form of holes in walls and floor. |
| 2) Random Access Memory | |
| 3) Switch Units | |
| 4) Power Cabinet | 4-6) Imbedded in walls via holes cut to accommodate equipment. Removal would leave holes in walls. |
| 5) Peripheral Equipment Shelf | |
| 6) Emergency Power Panels | |
| 7) SL-1 Lines | 7-10) Installed in building throughout the walls and ceiling. Removal would require demolition of the walls. |
| 8) 500/2500 Lines | |
| 9) Co/Watts/Fx Trunk Line | |
| 10) E & M Tie & Trunk Lines | |
| 11) Telephone Sets | 11) Attached to lines via modular jacks. |
| 12) Attendant Consoles | 12) Bolted jacks to floor and wired into system. |
| 13) Custom Software | 13) Programmed into processing unit. |

Petitioner's lease with the owner of the real property provides, in pertinent part, as follows:

"All alterations, decorations, installations, additions or improvements upon demised premises, made by either party, including all paneling, decorations, partitions, railings, and the like, shall, become the property of Landlord, and shall remain upon, and be surrendered with, the demised premises, as a part thereof, at the end of the term or renewal term, as the case may be, except that such furniture, furnishings, trade fixtures and business equipment as are not built into the demised premises and are installed by Tenant solely at its own expense may be removed."

Section 1105(c)(3) of the Tax Law imposes a tax on the receipts from the following service:

"Installing tangible personal property, . . . or maintaining, servicing or repairing tangible personal property . . . except . . . for installing property which, when installed, will constitute an addition or capital improvement to real property, property or land, as the terms real property, property or land are defined in the real property tax law as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this chapter . . . "

Section 1101(b)(9) of the Tax Law defines the term "capital improvement" as follows:

"Capital improvement. An addition or alteration to real property which: (i) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and (ii) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and (iii) Is intended to become a permanent installation."

The items numbered 7 through 10 in the above listing are installed in the real property in such a manner that they may be removed only by demolition of the walls of the building. Removal of these lines would thus cause material damage to the underlying real property. The lease between Petitioner and its lessor provides that installations built into the premises shall become the property of the lessor upon the expiration of the lease. The lease demonstrates an intention on the part of Petitioner and its lessor that installations in the nature of these telephone lines be permanent. The presence of these lines in the walls of the building leased by Petitioner substantially add to the value of the building. These lines, therefore, qualify as capital improvements under section 1101(b)(9) of the Tax Law. Accordingly, the amount paid by Petitioner to its contractor which is allocable to the installation of these lines is not subject to sales tax.

The custom software referred to above as item 13 is created, pursuant to Petitioner's instructions, in order to enable the telephone system to perform various functions desired by Petitioner. These functions include such matters as the generation of itemized billings for each extension and the restriction of each extension to certain types of calls. The software is purchased by Petitioner in the form of tape. The tape, once installed, can subsequently be removed and replaced

TSB-A-83(3)S
Sales Tax
February 15, 1983

by another tape. In addition, the software purchased by Petitioner is occasionally re-designed by the contractor, at Petitioner's request. Such software is of the type described in Technical Services Bureau Bulletin 1978-1(S) as being exempt from tax. Accordingly, Petitioner's purchase of such software is not subject to sales tax.

The remaining components of the telephone system (i.e., those numbered 1 through 6, 11 and 12) are not installed in such a manner that their removal would cause material damage to the underlying real property or to themselves, nor do they otherwise become part of the real property. Beamon Corporation, State Tax Commission Advisory Opinion, August 19, 1982. These components of the telephone system, therefore, do not constitute capital improvements within the meaning of section 1101(b)(9) of the Tax Law. Petitioner must therefore pay sales tax with respect to the purchase and installation of these components.

DATED: January 26, 1983

s/FRANK J. PUCCIA
Director
Technical Services Bureau